

A Work Project, presented as part of the requirements for the award of a Master's Degree in Management from the NOVA School of Business and Economics

HOW TO TURN PURA VIDA INTO A REFERENCE IN THE HEALTHY FOOD BUSINESS?

- INDIVIDUAL PART ON PRICING STRATEGY-

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Index

Introduction	1
Healthy Foods Retailing in Portugal	2
Pricing Strategies	2
Retailer Point of View	2
Manufacture Point of View	7
Pingo Doce Pricing Strategy	8
Pura Vida Pricing Strategy	9
Pricing Strategy for Each Su-bcategory	11
References	13
Appendices	14

LIST OF ABBREVIATIONS

HL	High/Low
EDLP	Every Day Low Price
PD	Pingo Doce
PL	Private Label
PV	Pura Vida
RGM	Retailer Gross Margin
COGS	Cost Of Good Sold

1. Introduction

Retailers offer to their customers a number of benefits, providing them with merchandising, normally at a convenient location. For that exchange of benefits, retailers charge money for the merchandising provided (Levy, M., Weitz, B. & Grewal, D. (2014)). Nowadays, retailers have pressure to lower the prices for the merchandising provided, due to the easiness in consumers' access to price information, therewith retailers put pressure on manufacturers to lower their prices, characterizing the marketplace by heavy discounting and sales promotions in order to fulfill the needs of their consumers.

With this access to price information, buyers can get instant price comparison from each retailer, and moreover check prices at the point of purchase between brands or between retailers. (Kotler & Keller, 2016).

Retailers and manufacturers brands before setting their pricing policy, require a full understanding of consumers psychology. Retailers can price itself to match its competition, to price higher, or to price lower. Making this decision, they must have to take into account several factors, such as the company, the customers, the competition and the marketing environment. (Kotler & Keller, 2016)

According to the literature, price is the one element of the marketing mix that produces revenues; however the other elements generate costs (Kotler & Keller, 2016). Thus, price is a very important decision factor that consumers use to compare alternatives, contributing to the company's positioning in the market.

This work project has two main goals. First understanding, and analyze existing pricing strategies in Healthy foods Retailing in Portugal, secondly we study according to theory a solution of pricing strategy from a manufacture point of view.

As a result this work is divided in two sections. The first section reviews the theoretical literature regarding the retail pricing strategy in the healthy food industry, followed by the analysis of the food retailer Pingo Doce (PD) according to the literature review. Section two a reviews the pricing strategy from the point of view of the manufacture, developing a proposal pricing strategy proposal for the Pura Vida (PV) private label (PL) for each product/range, ending with a recommendation of retail pricing guidelines for each of the product/range of PV.

2. Healthy Food Market in Portugal

In accordance with Euromonitor International (2015), healthy food and wellness food products in Portugal have been progressively penetrating the market, due to the awareness of the benefits of following a healthy food diet. However, regarding the consumers' side, the healthy food category is perceived as having high prices compared to standard products. Furthermore, retailers and manufacturers' brands, are investing in the healthy food category, since it is a growing category.

Through this investment, companies are still managing to achieve market share according to Euromonitor Internacional (2016), although retailers' brands channels are the market leader's in Portugal regarding the healthy food category. Being a growing category and also retailers being leaders in the market, PL have an opportunity to explore the market of healthy food to become the leaders of healthy food, as a result of being perceived as affordable and also being brands that have tendency to be on price promotion. However, to PL to become leaders, its needed to ensure the quality of the products. According to Euromonitor International (2015b) retailers continue exploiting their private label strategy in order to maintain margins and boost consumer's loyalty, while also directed on private label products to increase their price perception.

According to a research made by Nielsen in 2015 (appendix 1) Continente supermarket is clearly the leader in market share followed by PD, nevertheless Intermarché represents the best results in growth in this category of healthy hood. However, 8.6% of the market share belongs to other stores (specialized healthy food stores) like Celeiro, Miosótis and Brio supermarkets.

2.1 Pricing Strategies in Healthy food Retailing

2.1.1 Retailers Pricing Strategies

According to the theory, retailers have to choose between two very different pricing strategies, either Every Day Low Price (EDLP) or High Low (HL) price strategy. (Levy, Weitz, & Beitelspacher, 2014)

Every Day Low price

The main focus of this EDLP pricing strategy is to charge to the consumers low regular prices per product with little temporal price variation. In order to promising consumers an everyday low price, without the necessity to wait for sales price promotion in the market. However, using this pricing format doesn't mean that they have the lower prices in the market. Moreover, EDLP approach has it own advantages as follows:

- *Assures customers of low price:* many customers are skeptical about initial retail prices. EDLP strategy promises consumers that they will get the same low prices every time they patronize the EDLP retailer. (Levy, Weitz, & Beitelspacher, 2014)
- *Reduces Advertising and operating expenses:* the stable prices caused by EDLP, limit the need for the weekly-sale advertising. In addition EDLP retailers do not have to incur in labour costs of changing price tags and signs and putting up sales signs. (Levy, Weitz, & Beitelspacher, 2014)
- *Reduce stock outs and improves inventory management:* EDLP approach reduces the large variations in demand caused by frequent sales with larger markdowns. As a result, retailers can manage their inventories with more certainty. (Levy, Weitz, & Beitelspacher, 2014)

High/Low pricing

Stores that follow a HL pricing strategy are characterized by regular prices, exchanging between high and low prices, discounting the initial prices for merchandising through sales promotion, thus, consumers establish the value of the item in their minds, afterwards the retailer reduces the prices, encouraging the purchase by impulse. Hence, retailers that adopt the HL pricing strategy have the following advantages:

- *Increase Profits:* HL pricing allows retailers to charge higher prices to customers who are not price sensitive and will pay the higher price, and to charge lower prices to price sensitive consumers, who will wait for the low prices. (Levy, Weitz, & Beitelspacher, 2014)
- *Creates Excitement:* A “get them while they last” atmosphere often occurs during sale. Sales promotion draw a lot of customers, and a lot of customers create excitement. Some retailers augment low prices and advertising with special in store activities, such as product demonstrations, giveaways, and celebrity appearances. (Levy, Weitz, & Beitelspacher, 2014)

- *Sells merchandise:* Price promotion allows retailers to get rid of slow-selling merchandise by discounting price. (Levy, Weitz, & Beitelspacher, 2014)

2.2.1. Pricing Techniques Used by Retailers

Retailers use a variety of techniques to increase sales and profits, such as:

Variable pricing and price discrimination: is used by retailers to maximize profits by charging different prices to different customers. Beginning with the first degree of price discrimination, individualized variable pricing. The second degree of price discrimination, an alternative approach for variable pricing, and consists in offering the same multiple price schedule to all consumers, but requires that customers do something to, get lower prices. Furthermore, the third degree of price discrimination is variable pricing by market segment and zone pricing, which is the practice of charging different prices in different stores, markets, regions, or zones. Dealing with perception of fairness is another technique of price discrimination, by setting different prices for similar products or services. Another way to make such transactions seem fairer to customers is through customization. (Levy, Weitz, & Beitelspacher, 2014)

Leader pricing: Is pricing certain items lower than normal, to increase customer's traffic flow or boost sales of complementary products. Some retailers call these products loss leaders (sold below cost). (Levy, Weitz, & Beitelspacher, 2014)

Price Lining: Retailers frequently offer a limited number of predetermined price points within merchandise category, a practice known as price lining. Price lining can be used to get customers to trade up to a more expensive model. (Levy, Weitz, & Beitelspacher, 2014)

Odd pricing: Refer to the price of using a price that ends in an odd number typically a 9. Odd pricing has a long history in retailing. (Levy, Weitz, & Beitelspacher, 2014)

2.1.2 Food Retailers in Portugal

Theory states retailers need to choose from EDLP and HL, according to the company strategy (Levy, Weitz, & Beitelspacher, 2014). Regarding the EDLP pricing strategy, the retailers that choose this strategy are hard discounters retailers, like Aldi and Lidl, charging a constant low price (EDLP does not mean having the lower prices in the market) and sometimes using price reductions in the merchandising.

On the other hand, most of retailers in Portugal follow the pricing strategy of HL, such as PD,

Continente, Intermarche, Jumbo and specialized stores in healthy food retailing, meaning that the retailers charge higher prices on an everyday basis but runs frequent promotions with prices, creating excitements among shoppers. All of this retailers used loss leader pricing techniques as well as price discrimination through loyalty cards, charging different prices to different consumers, or another type of price discrimination, in order to increase consumers' loyalty.

However, we can divide these retailers in two, in the healthy food market, regarding the prices charged for the products. In one hand supermarket retailers like PD, and Continente, and on the other hand specialized stores as Celeiro and Miósotis.

Firstly, a supermarket sells a wide range of healthy food products through brands and private labels, and consumers have the choice to buy products regarding their household income. Nevertheless, specialized stores are seen as the providers of a high quality of healthy food products.

Secondly, the specialized stores address consumers that are willing to pay more money for healthy food products. Nevertheless, those are complemented with several different brands that promote a varied and very complete assortment that meets all types of demand as well as these stores provide an experience to their consumers, having specialized employees, in order to help and advise consumers about their needs, besides providing this experience, products are more expensive in these kind of stores, although they can buy some of the brands also available for cheaper prices in other places like in regular supermarkets.

2.2 Pricing Strategies For Manufacturer Brands:

According to Nagle & Holden (2002, p.141-154), it is important for manufacture brands to establish a pricing objective in order to establish their positioning in the market. According to literature, there are three main pricing strategies: skimming, penetration and neutral market pricing strategies.

- *Skimming*: This strategy is designed to capture high margins at the expenses of large sales volume, meaning that prices are high in relation to what most buyers in a segment can be convinced to pay. Implementing this strategy optimizes immediate profitability only when the profit from selling to relatively price sensitive customers exceeds that from selling to a larger market at a lower price. However, product might generate more profit in the log-run by setting the initial prices high and reducing over time. (Nagle & Holden, 2002)

- *Penetration*: This pricing strategy is defined by setting a price low enough to attract and hold large bases of customers. Applying this strategy does not mean having necessarily cheap products, means that the products' prices are low regarding the perceived value in the target segment. Penetration works best when a large share of the market is willing to change brands or suppliers in response to lower prices. Applying penetration pricing can induce a price war among the competition. (Nagle & Holden, 2002)
- *Neutral*: This strategy is not used to gain market share, thus neutral pricing minimizes the role of pricing in the marketing mix, where another tactics that can be more powerful for a product market. Neutral strategy is used in industries where customer are quite value sensitive. (Nagle & Holden, 2002)

The existing manufacturer brands in the healthy food category, such as Gullon, Cem Porcento, Alpro, Schär and Bicentury among others, are brands that apply the skimming pricing strategy, having high prices in the market, being perceived as having high quality products and trustworthiness. However, these brands do not feel threaten by private labels brands, although these brands have to adapt to the retailers pricing strategies. Concerning private labels brands, like Pura Vida (Pingo Doce), Área Viva (Continente), and Viver Melhor (Jumbo), followed a neutral pricing strategy, matching their prices to their main competitors.

2.3 Pingo Doce Pricing Strategy

PD's pricing strategy is supported by academic literature. PD operates in the food industry with a pricing format of HL pricing strategy meaning that PD stores are characterized by regular prices, punctuated by frequent promotion and sales. PD offers a variety of food and non-food assortment, with a highly competitive pricing policy, and with opportunities for immediate savings. (Levy, Weitz, & Beitelspacher, 2014)

Using the HL pricing strategy, we can confirm with literature review from several characteristics that PD has. First of all, the heavy investment in advertising, as the company produces weekly leaflets to communicate promotion to their consumers and attract them to go to the store, and with radio advertising also to promote the promotion in store. All of this investment in communication is typically from a retailer that adopts the HL pricing policy. (Levy, Weitz, & Beitelspacher, 2014)

Another characteristic of HL strategy used by PD is to encourage consumers to buy products by impulse, increasing the amount of products in promotion near the checkout points, encouraging this type of purchase.

PD also develop loyalty programs, since in 2013 PD launched the loyalty card, “Poupa Mais”, where customers were able to enjoy exclusive discounts in PD stores and also access to discounts in BP gas stations: for each 40€ spend in grocery shopping, customers accumulate immediately 2€ to spend in gas.

With these characteristics, PD follows the pricing technique of Leader price, supported by literature review, which means that in order to attract customers and create traffic flow, PD is pricing certain items lower than normal to achieve its goals (promotions), to increase sales, profits and store traffic. Therefore, using price discrimination through a loyalty card, it is able to charge different prices to different consumers.

3. Pura Vida Pricing Strategy

PV being a PD private label, the main focus for PV, towards the eyes of the consumer, to become a brand with affordable healthy food products. In order to provide to their consumers a daily healthy eating diet and therefore fulfill their main needs. Being associated with PD, positive association of high quality products will be transferred to PV products. Nevertheless, being a PD PL, products from PV have high margins comparing to the average margins of PD products.

The introduction of PV in the category of health food with a vast number of products, in the overall of sub-categories, the pressure the competition and may strengthen the bargaining position of the retailer against manufacturer brands. Furthermore, PD has the overall control in the distribution channel, such as shelf space, promotion and pricing, which PL can take advantage from it.

In accordance with the category management section, the role of the category of healthy food is defined as a convenience role. PV belonging to this category provides to consumers a good perception of the retailer as well as being one stop shopping, on the other hand the convenience category role has an important part regarding profit generation and having a high gross margin. However, some sub-categories of PV follow another role such as destination and preferred role. (ECR)

Each category role has its main goal to define what the retailer wants to accomplish in the

category, in this case profit maximization and achieve the best prices in the competitive market (ECR). PV overall belonging to convenience role, which aims to give emphasis to profit, measures and enhances PD's image, some sub-categories follow another roles. Destination role as the feature to emphasize the market share and turnover growth, and on the other hand preferred role emphasizes profit generation. (ECR) (Appendix 2)

To be aligned with PV's main objective of providing an affordable wide range of products within the ten defined sub-categories (wholegrain, seeds, free-from, healthy ready meals (refrigerated), healthy drinks, healthy snacks, soy products, condiments, bio/organic, supplements and sport nutrition), establishing the most suitable pricing strategy is crucial.

Bearing in mind the three pricing classifications, which include the skimming pricing (defined by setting the price above competition), the neutral pricing (defined by setting the price similar to competition) and the penetration pricing (defined by setting the price below the competition), the best option for PV is to apply a neutral pricing approach for the majority of its assortment. However, since PV is expected to be recognized by its quality and its good value-for-money, even if it has the same price as the competition, consumers are more prone to choosing it over the other brands.

This strategy would cover the seeds, the healthy snacks, the healthy drinks, the soy products, the supplements & sports nutrition, and the free-from (specifically the sugar-free and salt-free) sub-categories.

Nonetheless, exceptions should be made regarding some specific sub-categories. On one hand, the skimming pricing can be applied to the condiments, bio/organic, ready meals and free-from (specifically gluten-free) sub-categories, in order to generate profits through targeting less price sensitive consumers. In fact, the products present in these sub-categories are scarce in the market, and PV can take advantage from being one of the few suppliers to provide them, thus being able to achieve higher margins. Yet, skimming wouldn't apply for the majority of the assortment, because if PV would follow it, its prices would be too high when compared to competitors, thus being considered as a premium and not as an affordable brand.

On the other hand, penetration pricing can be applied to the wholegrain and free-from (specifically lactose-free) sub-categories, in order to generate traffic in store. Indeed, the products present in these sub-categories are already saturated in the market and therefore by

lowering the price, it is more likely that consumers will be attracted to PV rather than other brands. Still, if PV would follow an overall penetration strategy, its prices would be too low when compared to its competitors, thus being considered as a low quality brand.

Moreover, since PV is a retailer private brand, it has to be aligned with PD's pricing strategy (Levy et al., 2014). More precisely, PD follows a high and low pricing strategy, characterized by regular prices, yet exchanging between high and low prices. This means that PV will have constant promotions in-store, which will vary according to PD (N. Jesus (Jerónimo Martins) personal communication, May 7, 2016). These price-off promotions will be in the form of discounts through the leaflet and via special deals through the usage of the loyalty card *Poupa Mais*, both aiming at stimulating purchase behavior. On one hand, the leaflet discounts are meant to every customer. On the other hand, the loyalty card discounts are meant for those who have the *Poupa Mais* card. Normally, PD applies a promotional discount between 25% and 35% to its PL brands.

Normally, PD applies a promotional discount between 25% and 35% to its PL brands. As a summary, the neutral pricing strategy is the most used one, since it respects the positioning it is set for PV, but there are some sub-categories which profit from following a different approach, namely the skimming and the penetration. Regardless, PV has also to be aligned with PD's high and low pricing strategy, thus making promotions via the leaflet and the loyalty card. In Appendix 3 the pricing strategy for each of PV's sub-categories and selected products can be consulted.

3.1 Pura Vida Pricing Strategy For Each Sub-Categories And Products

Since PV is a manufacturer PL brand, it is important to understand how it sets the value breakdown (De Jong et al., 2015). For a PL brand, the breakdown value is composed by several components (see Appendix 4 for a simulation example). Hence, in order to comprehend what is the average gross margin that PV can achieve for each sub-category through each applied pricing strategy, it is necessary to understand how PD sets its price. When PD wants to launch a new product or sub-category in the overall private label assortment and it already exists in manufacturer brands, PD follows a general rule (N.Jesus (JerónimoMartins) personal communication, May 7, 2016). This rule is based on taking the percentage of the VAT, according to each product and then deducts 25% to the price of the manufacturer brand. Such method provides an idea of how much the private label brand

should be priced in the market. Following this, all the proposed products that already exist from manufacturer brands will be priced accordingly.

Moving forward, and considering the development of the estimated average profit margin for PV, it is necessary to take into consideration the average gross margin that the brand had in 2015, which was 34% (Jerónimo Martins, (n.d.[g])). Indeed, this reference number is an assumption, because there is no information on the value of the cost of goods sold (COGS). Besides, it is also necessary to take into consideration the percentage of the VAT that is applied for each product of each sub-category, according to the tax authority in Portugal (Appendix 5), because products have VATs of 6%, 13% and 23%. Specifically, by taking into account these assumptions, the rationale to calculate margins for each pricing strategy is based on the following:

For the products of the sub-categories that follow a neutral pricing strategy (Appendix 6), it is maintained the average gross margin of 34%, always taking into account that after the gross margin, it is necessary to add the respective percentage of the VAT. For healthy drinks, the soy products and the healthy snacks, the VAT is 6%, with exception of the products based on wheat, in which the VAT is 13%. As for the seeds, the VAT is also 13%, and for supplements & sports nutrition, and sugar-free product the VAT is 23%.

For the products of the sub-categories that follow a skimming pricing strategy (Appendix 7), in order to generate higher margins, 15% is assumed to be added to the average gross margin of 34%. Again, this excludes the value of the VAT, thus it is necessary to add it. For the condiments, for the bio/organic and for the gluten-free products, the VAT corresponds to 6%, and as for ready meals the VAT is 13%.

For the products of the sub-categories that follow a skimming pricing strategy (Appendix 8), 10% is assumed to be deducted from the average gross margin of 34%. Despite seeming counterintuitive, since this decision generates less gross margin when compared to other products, however these products are able to generate more traffic in-store. Furthermore, 6% of VAT should be added to the lactose-free products and to the wholegrain sub-category should be added to the lactose-free products and to wholegrain sub-category.

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Appendices

Appendix 1: Market share regarding healthy food industry (Nielsen source)

Market share (YTD Wk 36/2015)		PD	CNT	ITM	LIDL	MP	JMB	OTHER S
HEALTHY FOOD	Quota (%)	27,3	32,0	10,5	5,4	7,5	8,0	9,2
	Var Quota (pp)	-0,4	0,4	2,1	0,5	-1,2	-0,1	-1,3
SOY DRINKS	Quota (%)	21,0	38,4	8,0	1,8	10,6	11,0	9,2
	Var Quota (pp)	-0,3	-0,8	1,3	-2,3	1,4	0,2	0,6
SOY YOGURTS AND DESSERTS	Quota (%)	19,7	39,5	11,5	8,1	4,4	13,2	3,6
	Var Quota (pp)	-8,2	5,3	1,3	-0,6	-0,6	4,4	-1,7
TOTAL	Quota (%)	24,5	34,8	9,9	4,7	8,1	9,5	8,6
	Var Quota (pp)	-1,4	0,8	1,7	-0,5	-0,4	0,6	-0,9

Source: Nielsen| YTD Wk36/2015

Appendix 2: Healthy food Category Role

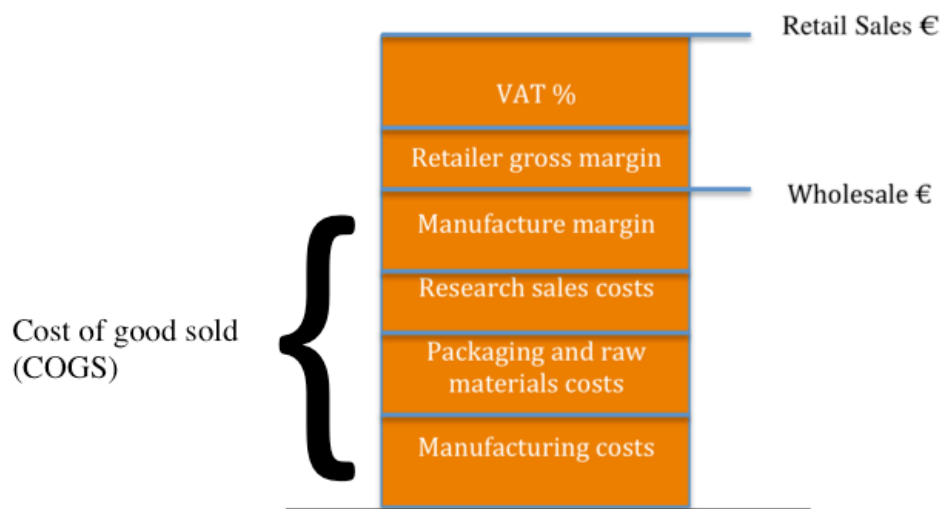
	Sub-Category	Category Role
Healthy Food Category (Convenience Role)	Wholegrain	Preferred
	Seeds	Preferred
	Free-From	Destination
	Gluten-Free	Destination
	Lactose-Free	Destination
	Sugar-Free	Preferred
	Salt-Free	Preferred
	Healthy Snacks	Convenience
	Healthy Drinks	Convenience
	Soy Products	Preferred
	Condiments	Convenience
	Supplements/ Sports Nutrition	Convenience
	Bio/ Organic	Convenience
	Fresh Ready Meals	Convenience

Appendix 3: Sub-categories and products strategies

Pricing Strategy	Sub-categories and Products
Neutral	<ul style="list-style-type: none"> - Seeds - Healthy snack <ul style="list-style-type: none"> o Biscuits o Cookies o Tortitas - Soy products <ul style="list-style-type: none"> o Yogurts o Milk o Cooking cream - Healthy drinks <ul style="list-style-type: none"> o Infusion

	<ul style="list-style-type: none"> ○ Juices - Supplements and Sports Nutrition - Free-from <ul style="list-style-type: none"> ○ Sugar-free
Skimming	<ul style="list-style-type: none"> - Free-from <ul style="list-style-type: none"> ○ Gluten-free - Condiments - Bio/ Organic - Fresh Ready Meals - Healthy drinks <ul style="list-style-type: none"> ○ Flavored PH water
Penetration	<ul style="list-style-type: none"> - Wholegrain - Free-from <ul style="list-style-type: none"> ○ Lactose-free

Appendix 4: Value Breakdown of a private label



Appendix 5: Tax Authority in Portugal

GOODS AND SERVICES SUBJECT TO REDUCED RATE 6%

Food:

Cereals and cooked cereals :

- Cereals
- Rice (in film, milled, polished, glazed, parboiled, converted into cracks)

- Flours, including dairy and non-dairy
- Pasta and similar dry folders, excluding stuffed pasta
- Bread
- Seitan, tofu, tempeh, textured soy
- Milk and dairy products
- Milk in nature, concentrated, sterilized, evaporated, pasteurized, condensed, fermented in blocks, powder or granules and cream
- Dietetic Mkls
- Butter, with or without the addition of other products;
- Cheese
- Yogurts, including unpasteurized yogurt
- Milk chocolate milk, flavored, vitamin and enriched
- Beverages and dairy desserts
- Drinks and soy yogurts, including tofu

Fats and fatty oils:

- Olive oil

Fruits and vegetables:

- Legumes and vegetables, fresh or chilled, dried or dehydrated
- Vegetables and frozen vegetables, although previously cooked
- dried leguminous vegetables, shelled, although in the film
- Fruits in the natural state or dehydrated.
- Water, with the exception of spring water, mineral, medicinal and table, carbonated water or added carbon dioxide or other substances.
- Waters, except for the added water other substances
- Spring waters and mineral waters, although reinforced or added carbon dioxide, without the addition of other substances.
- Salt (sodium chloride)
- Sea salt
- Juices and nectars of fruit and algae or vegetable drinks and cereals, almonds, cashews and hazelnuts without alcohol
- Dietary products for enteral nutrition and gluten-free products for celiac patients.

GOODS AND SERVICES SUBJECT TO RATE INTERMEDIATE 13%

Products for human consumption:

- Fruits
- Canned fruit, particularly in sauces, brine or syrup
- Jams, jellies, marmalades or pastes
- Nuts, shelled or unshelled

Vegetables:

- Canned vegetables, particularly in sauces, vinegar and brine and their jams

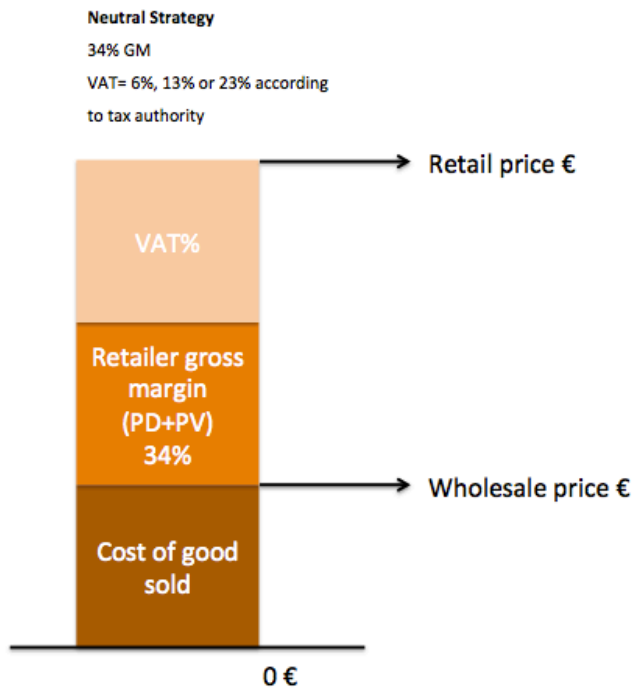
Edible fats and oils:

- Directly edible oils and their mixtures (edible oils)
- Margarines of animal and vegetable origin
- Based snack of vegetables and seeds
- Meals ready to eat in ready to eat and take or home delivery schemes
- Appetizers and snacks based extruded corn and wheat, the base of ground and fried corn or potato starch, in individual packaging
- Spring water, mineral, medicinal and table, carbonated water or added carbon dioxide, with the exception of water added other substances

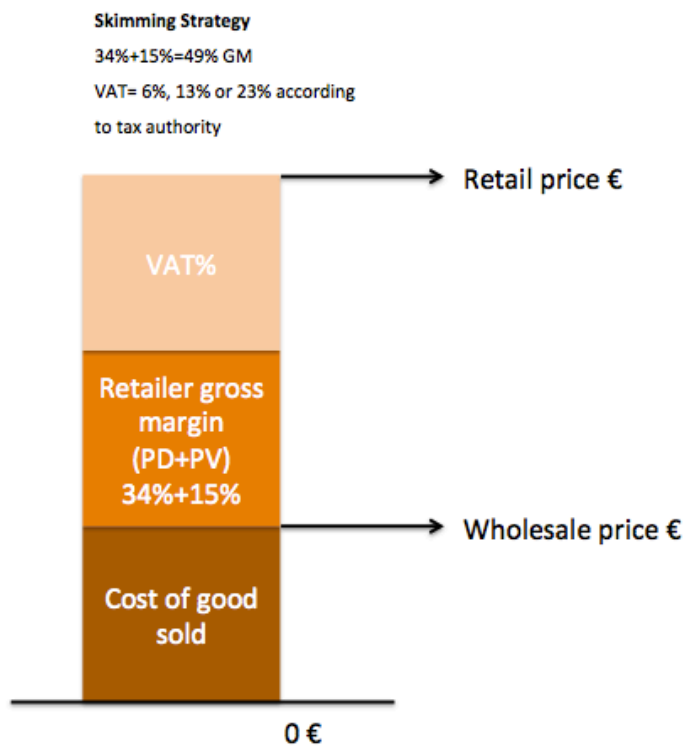
VAT%	PORTUGAL
Normal Rate	23%
Intermediate Rate	13%
Reduced Rate	6%

***Note: products that are not included in this list, have a VAT of 23%**

Appendix 6: Value Breakdown for Neutral strategy



Appendix 7: Value Breakdown for Skimming Strategy



Appendix 8: Value Breakdown for Penetration strategy

